Solution 11.1

Part A

An intangible asset is an identifiable non-monetary asset without physical substance.
An asset is:
- a resource,
- controlled by the entity,
- as a result of a past event,
- from which future economic benefits are expected to flow.

The market share does not have physical substance and is non-monetary and thus the issue is whether the market share is identifiable.

An asset meets the identifiability criterion in the definition of an intangible asset when it
- Is separable, or
- Arises from contractual or other legal rights
  (IAS 38, p12)

The market share is not separable from the business as a whole and it does not arise from legal rights.

The market is a resource in that it generates sales for the company.

The event was the creation of the customer loyalty that constitutes the market share (perhaps through entertainment, advertising etc). This event is a past event if the creation occurred before year-end.

Future economic benefits can be expected from the market through sales made to customers that form part of the market.

There is, however, little or no control over a market since a company's market can be easily usurped by another company offering better products, service, advertising etc.

Therefore, the market share should not be recognised as an intangible asset (not identifiable and not controllable).

Part B

An intangible asset is an identifiable non-monetary asset without physical substance.
An asset is:
- a resource,
- controlled by the entity,
- as a result of a past event,
- from which future economic benefits are expected to flow.

The patent and the staff skills are identifiable (sold, leased or rented out separately and/ or are identifiable through legal rights: registered patent). (IAS 38, p15)
Both the patent and staff skills are non-monetary and do not have physical substance.
Thus the issue is whether or not they meet the definition of an asset.

The patent and staff skills are a resource in that they can be used to generate sales of software and services provided by their staff.

Solution 11.1 continued …

Part B continued …

The past event would be the hiring of staff and creating the patented software prior to the year-end.
The future economic benefits would be expected through the sale of the software and services offered by its staff.
An entity controls an asset (and therefore, an intangible asset) if it:

- Has the power to obtain future economic benefits from the item and
- Is able to restrict the access of others to those benefits
  (IAS 38, p13)

The company controls the future benefits from the software and the knowledge is protected by the legal rights of the patent.

Although the company will obtain future benefits from the work performed by the staff, the company does not have control over their skills as the staff can resign at any time by giving one month's notice.

Therefore, the patent must be recognised as an intangible asset but the staff skills cannot be recognised as an intangible asset.

Part C

The licence to operate the toll road is an intangible asset with a finite useful life. Therefore, the cost of C 10 000 000 is amortised on a systematic basis over its estimated useful life (originally being twenty years), in line with the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
(IAS 38, p97)

The residual value is zero as there is no active market for toll road licences.
(IAS 38, p100)

The straight-line method is used only if it reflects the pattern of future economic benefits or if the expected pattern of future economic benefits cannot be estimated reliably. During the eighteenth year, it was estimated that the useful life in cars would be 1 800 000 cars (Yr 18: 800 000 + Yr 19: 600 000 + Yr 20: 400 000). Since the pattern has changed from an even usage of 1 000 000 cars per year over the remaining 3 years, a more appropriate method of amortisation would be to use the number of cars using the road instead. This change is accounted for as a change in accounting estimate in terms of IAS 8.

CA at the 18th year is 1 500 000 (10 000 000 / 20 * 3)
This is then amortized over 1 800 000 cars as follows:

- Year 18: C666 667 (C1 500 000 / 1 800 000 x 800 000 cars)
- Year 19: C500 000 (C1 500 000 / 1 800 000 x 600 000 cars)
- Year 20: C333 333 (C1 500 000 / 1 800 000 x 400 000 cars)

Solution 11.2

Recognition:

The issue here is whether the cost of the fishing licence should have been expensed or recognised as an intangible asset.

To be recognised as an intangible asset, the item must meet the definition of an intangible asset and the recognition criteria.

An intangible asset is defined as an *identifiable* non-monetary *asset* without *physical substance.*

- The fishing licence is *identifiable* as it arises from a legal right to fish in the demarcated area
- As an *asset*, the intangible asset must be a resource controlled by the entity, from a past event and must result in an expected inflow of future economic benefits
  - Hurtigruten Limited does have control over the fishing licence as no other company may fish for tuna in the demarcated area during the term of the licence.
  - The past event is the acquisition of the license before year-end.
  - Future economic benefits should flow through increased revenue from the sale of fish.
- The fishing licence (although the related documentation has physical form), does not have *physical substance* as the most significant aspect is the licensed ability to perform fishing.

Applying the recognition criteria,

- As the fishing license is a separately acquired intangible asset, the probability of future economic benefits is satisfied (IAS 38 allows this criteria to be assumed in such an instance).
- The cost is reliably measured as an amount of C 600 000 was paid for the fishing license.

Conclusion:
The licence should be capitalized as an intangible asset since it meets the relevant definition and recognition criteria.

Measurement:

- The fishing licence has a finite life and must be amortised.
- The life is determined as the shorter of the actual life and legal life.
- The actual life is not relevant but the licence provides the company with a legal life of four years.
- The residual value is zero.
- The pattern of future economic benefits is not apparent and therefore the straight-line may be used as the default method of amortisation.
- Amortisation of C150 000 must be expensed during 20X6 [(C600 000 – 0) / 4 years x 1 year]
- An impairment test would have to be performed. Assuming there is no indication of impairment, the recoverable amount would not need to be calculated. It is assumed that the asset is not impaired, since there is no information provided regarding any evidence thereof.
- The carrying amount of the licence will therefore be measured at C450 000 (Cost: 600 000 – Accumulated amortisation: 150 000 - Accumulated impairments: 0).

Solution 11.2 continued …

Disclosure:

- The carrying amount of the licence would be included in the line item 'intangible assets' on the face of the statement of financial position.
- The amortisation expense would be included in the calculation of the profit before tax line item in the statement of comprehensive income.
- Accounting policies relating to intangible asset would need to be disclosed.
- The roll forward of the opening and closing carrying amount for the licence is included in the intangible asset note.
- The amortization is disclosed in the profit before tax note.

Solution 11.3

Part a) N-Gee brand

i) Acquisition of N-Gee brand

In terms of IAS 38, an item must meet all the components of the definition of an intangible asset in order to be capitalised – if not, it must be expensed.

An intangible asset is thus:

- *Definition of an asset*
  - Resource controlled by enterprise
  - from past events
  - from which future economic benefits are expected to flow

- *Definition of an intangible asset*
  - Identifiable
  - non-monetary asset
  - without physical substance

The brand, N-Gee has been purchased and is therefore a *resource which is controlled by the enterprise* due to the fact that Quencher has the power to obtain the future economic benefits flowing from this brand, and to restrict the access of others to these benefits. This would be legally enforceable in a court of law.

The *past event* is the purchase transaction of the brand, which occurred on 1 April 20X5.

Future economic benefits expected to flow from the purchase of the brand, will result from the sale of the N-Gee soft drinks.

Indentifiability is met, as the brand name is capable of being *separated* and arises from a *legal right* as it has been sold individually and for a specific value in the sale transaction that occurred in April 20X5.

Although there may be legal documentation on paper, the brand purchased has *no physical substance* and is considered intangible.

However an intangible asset can only be recognised if:

- it is probable that the future benefits that are attributable to the asset will flow to the entity
- and the cost can be reliably measured.

It is *probable* that the brand should give rise to *future economic benefits*, which will arise from future sales of the N-Gee drink. Since the brand name has been purchased by Quencher, all future benefits will flow directly to the entity. In addition, the price an entity pays to acquire separately an intangible asset reflects expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the asset. The *cost can be reliably measured* as this is known: the purchase price paid for the brand was C 2.5million.

The brand, N-Gee should therefore be recognised as an asset in terms of IAS 38: Intangible Assets.

Solution 11.3 continued …

ii) Accounting treatment of all N-Gee costs

As discussed above, the brand, N-Gee should be recognised as an asset in terms of IAS 38: Intangible Assets. The amount capitalised should be the purchase price plus any directly attributable expenditure. Therefore an amount of C2 675 000 (the purchase price of C2 500 000, as well as the legal fees incurred of C175 000) should be capitalised.

The brand should be amortised over its estimated useful life of fifteen years.

The staff training costs of C 200 000 which were incurred in order to train staff to produce this new product should be expensed during the year ended 31 May 20X5. The definition of an asset is not met in terms of The Framework since the trained staff members may not necessarily be under sufficient control of the entity to be considered to be an asset.

Part b) Internal generation of patent for Flip top can

Research involves the search for new scientific or technical knowledge. Development involves the application of these research findings with the aim of using it in commercial production or in the business.

For an item to be recognised as an asset, it must meet the asset definition and also meet the recognition criteria:(the cost or value must be reliably measurable; and the inflow of expected future economic benefits must be probable.)

By the very nature of research, the inflow of future economic benefits cannot be said to be probable (although they may be considered to be possible) since it is merely investigations that are being performed. For this reason, research costs must be expensed.

Development costs, on the other hand, may result in a resource where the expected inflow of future economic benefits is probable. Development costs must be capitalised if the criteria per IAS 38 are met: the cost or value is reliably measurable; and the inflow of expected future economic benefits are probable. The inflow of future economic benefits are considered to be probable when all of the 6 criteria per IAS 38 (par 57) can be demonstrated.

If just one of these criteria is not demonstrable then the development costs *must* be expensed. Once all these criteria are met, it can be said that future economic benefits are probable and that there is a cost that can be reliably measured.

Expenditure on the **research** phase of the project should be *expensed*. For the year end 31 May 20X5, this will be C 240 000 and will include:

- C 40 000 for market surveys
- C 200 000 for evaluations of the prototypes and designs

The research phase of the project should end on **30/09/20X4,** once the design is chosen and engineers produce a plan which indicates that it is technically possible to produce the Fliptop can.

Solution 11.3 continued …

Part b) continued …

Expenditures from 01/10/20X4 relating to the **development** phase may be *capitalised* as an intangible asset if Quenchers can demonstrate that the 6 conditions have been met:

The technical feasibility of completing the intangible asset so that it will be available for use or sale.	After the evaluation of a number of prototypes and designs, Quenchers began development of a pilot plant, and engineers produced a plan which indicated that it was technically possible to produce the fliptop can.
Its intention to complete the intangible asset and use or sell it.	Quencher has applied to register the Fliptop can as a patent.
Its ability to use or sell the intangible asset.	Market surveys
How the intangible asset will generate probable future economic benefits.	Detailed market research was carried out by Quenchers, prior to 01/10/20X4, which indicates that the cans will be able to be used and will generate future economic benefits for the company as there is a market for the product.
The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.	Adequate funding was obtained prior to the project beginning, which indicates that the company has the necessary resources to complete development.
Its ability to measure reliably the expenditure attributable to the intangible asset during its development.	The expenditure attributable to the development of the asset have been able to have been reliably measured.

Development costs amounting to C 1 700 000 should be **capitalised** at 31/05/20X5.
This includes the following:

- C 1 100 000 – Design and construction of a pilot plant
- C 600 000 – Testing of a pilot plant

Since the development is not yet completed and therefore has not yet been put into production, amortization of this intangible asset should not yet begin. As a result, this is classified as an 'intangible asset not yet available for use'. This means that impairment testing must be done every year (this can be done at any time during the year, but should be done at the same time every year). In the case of 'intangible assets not yet available for use', the impairment testing requires that a recoverable amount be calculated even if the indicator review does not suggest that an impairment may have occurred.

Solution 11.4

a) Definitions and recognition criteria relevant to the acquisition of a trademark

The trademark acquired via a business combination, may only be recognised when both the definition of an intangible asset and the recognition criteria are met.

A trademark is an intangible asset, the definition of which is as follows:
- a resource
- controlled by the entity
- from a past event
- from which future economic benefits are expected to flow
- separately identifiable
- non-monetary
- non-physical.

The recognition criteria include:
- the flow of future economic benefits is probable; and
- the cost or value thereof is reliably measurable.

The trademark is a non-monetary resource that has no physical substance. Food Limited controls the trademark (i.e. has the ability to restrict access to the trademark and has the power to obtain the related economic benefits) through the purchase agreement. The past event is the signing of the purchase agreement. Future economic benefits are expected through the use of the trademark and are probable since the trademark has been profitable for many years already.

The most difficult aspects of the definition and recognition criteria to meet when purchasing an intangible asset as part of a business combination are:
- it must be separately identifiable (from goodwill and the other assets acquired): (part of the definition); and
- has a cost or value that can be reliably measured: (part of the recognition criteria).

In the event that the trademark
- cannot be separately identified and /or
- cannot be reliably measured,

then the entire excess paid should be classified as purchased goodwill (and not as a trademark).

In order to separately identify an intangible asset, it must
- be 'separable', i.e. be capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; OR

- arise from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Since the trademark is mentioned in the purchase agreement as being acquired by Food Limited, it is considered to be separately identifiable through contractual rights.

Solution 11.4 continued …

As already mentioned, it is generally difficult to reliably measure the cost or value of the trademark in this instance since, by definition, there can be no active market for trademarks. Where an active market does not exist, the fair value will either be:

- the amount that would have been paid for the asset at date of acquisition, in an arm's length transaction between knowledgeable and willing parties; or
- another method of calculating the estimated fair value (e.g. discounted cash flow projections) so long as a *reliable* estimate results.

Although the trademark is separately identifiable from goodwill it would still form part of goodwill if the fair value is not reliably measurable.

b) Initial recognition

The trademark must initially be measured at its cost (measured at its fair value with reference to an active market or in another manner).

The trademark may therefore only be recognised at C20 500 if the definition and recognition criteria are met and more specifically if it can be proved that the

- C20 500 is a reliable measure of its cost; and that
- the trademark can be separately identified from the other assets and goodwill.

If recognition of the trademark is not allowed (because the definition, recognition criteria or both are not met in full), then the excess paid (C20 500) is recognised as goodwill instead.

c) Amortisation

If an intangible asset is believed to have an indefinite useful life, no amortisation will be processed. An intangible asset may be assessed as having an indefinite useful life, when 'there is no foreseeable limit over which the asset is expected to generate net cash inflows for the entity'. Although the trademark indicates unlimited profitability, Food Limited has purchased the trademark for a period of 22 years only. This means that the trademark can only generate net cash inflows *to the entity* for a period of 22 years. It should be noted that the legal life will not be a limiting factor if:

- the legal rights are renewable; and
- there is evidence to suggest that the rights will be renewed at no significant cost.

There is no evidence apparent from the question that the legal rights to the trademark are renewable and renewable at *insignificant* cost. The trademark should therefore be amortised over 22 years.

It should also be noted that the residual value (for the purpose of calculating the depreciable amount) should be taken as zero, unless

- a third party has committed to purchasing the asset at the end of its useful life; OR
- there is an active market and it is possible to determine the residual value using that market and it is probable that the active market will still be in existence at the end of the asset's useful life

Intangible assets are usually amortised on the straight-line method unless a more suitable method can be established (in relation to the expected pattern of expected flow of future economic benefits) although IAS 38 states that there is rarely a justifiable situation in which the method used results in a lower 'accumulated amortisation' balance than had the straight-line method been used instead.

Solution 11.4 continued …

d) Impairment testing and revaluing to fair value

An annual indicator review is mandatory for all intangible assets to assess whether or not there is a possible impairment, in which case the recoverable amount must be calculated and compared with the asset's carrying amount.

Intangible assets may be revalued to fair values under the revaluation model, but these fair values must be obtained with reference to an active market.

For an active market to exist, the following criteria should be met:

- The items traded within the market are homogenous
- Willing buyers and sellers can be found at any time
- Prices are available to the public.

By definition, there can be no active market for trademarks since an active market requires that the items traded are homogenous and the trademark, by nature, is unique.

The trademark may therefore not be revalued to its fair value since the fair value is not reliably measurable. The trademark must, however, be checked for impairments at the end of every year.

Solution 11.5

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development involves the application of these research findings or other knowledge to a plan or design for production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

For an item to be recognised as an asset, it must meet the definition of an asset and also meet the recognition criteria:

- the cost or value must be reliably measurable; and
- the inflow of expected future economic benefits must be probable.

By the very nature of research, the inflow of future economic benefits (although perhaps possible) cannot be said to be probable since the investigation is in its infancy. For this reason, research costs must be expensed.

Development costs, on the other hand, may result in a resource where the expected inflow of future economic benefits is probable. Development costs must be capitalised if (criteria stipulated in IAS 38):

- the cost or value is reliably measurable; and
- the inflow of expected future economic benefits are probable. The inflow of future economic benefits is considered to be probable when all of the following can be demonstrated:
  - the technical feasibility of completing the asset;
  - the intention to complete the asset and to either use or sell it;
  - the ability to use or sell the asset;
  - how the asset will generate future economic benefits, through, for instance, demonstrating that there is a market to sell to, or if the asset is to be used internally, then the usefulness thereof; and
  - the adequate availability of necessary resources (technical, financial or otherwise) to complete the development and to sell or use the asset.

It is interesting to note that if these criteria are met, then the development costs *must* be capitalised, but if any one of the criteria are not met, then the development costs *must* be expensed.

Once the development costs are capitalised, amortisation must begin. It is also interesting to note, that if costs incurred do not meet the criteria initially and are expensed as a result, these costs *may not* be capitalised at a later date assuming the criteria are subsequently met.

Solution 11.6

The capitalisation of the cost of the original brand name is correct.

Since the brand was considered to have an indefinite useful life, it was correct not to amortise the cost.

The classification as an intangible asset with an 'indefinite useful life' should, however, have been reviewed annually: as soon as there was an indication that the brand had a finite useful life, amortisation should have been recognised as a change in accounting estimate.

Similarly, the recoverable amount of the brand should have been recalculated at the end of every year, irrespective of the results of an indicator review, since it has been classified as having 'an indefinite useful life'. The drop in sales of Yog-Nog in recent years indicates that the recoverable amount would have been less than the carrying amount, in which case an impairment loss should have been processed.

On abandonment of the Yog-Nog brand name, it is correct to write-off the balance of its carrying amount (since there are no further economic benefits expected from its use or disposal).

Depending on the materiality of the failure to:
- amortise the brand once it became apparent that it had a finite life; and
- impair the brand in each of the years during which the recoverable amount was less than the carrying amount

this should be treated as a correction of an error.

IAS 38 specifically disallows the capitalisation of the internally generated brand name 'Yogi-Yippi' on the grounds that it is too difficult to prove that the recognition criteria have been met (i.e. reliable estimates of the costs of creation are almost impossible since the costs incurred will be difficult to separate from the general costs of running the business). The launch costs of Yogi-Yippi should therefore be expensed as marketing costs.

Solution 11.7

Capitalisation

- It is correct to capitalise the brand at its original cost (assuming the definition of an asset and the recognition criteria were met).

Amortisation

- It is correct that an intangible asset that has been classified as having an indefinite useful life should not be amortised.
- The useful life of the 'pie' brand, although purchased for a period of only 30 years, may be renewed and this renewal is at an insignificant cost. It is therefore acceptable to classify this brand as having an indefinite useful life and therefore it is correct that no amortisation be processed.
- The status of the useful life of the brand as being 'indefinite' must be reassessed every year.

Impairment testing

- It is not acceptable, however, to fail to estimate the recoverable amount annually.
- Since the 'pie' brand is classified as having an indefinite useful life, the recoverable amount must be calculated irrespective of whether or not the indicator review suggests a possible impairment.
- The only instance where the recoverable amount of an indefinite useful life asset need not be calculated is when:
  - the intangible asset is part of a cash generating unit and
  - there is a previous detailed calculation done in the immediately preceding year
  - where the recoverable amount was 'substantially greater' than the carrying amount and
  - where 'events and circumstances subsequent to this calculation suggest that there is only a remote chance that the current recoverable amount would now be less than the carrying amount'.

  Since this previous detailed calculation indicated an immaterial difference between the recoverable amount and carrying amount of the 'pie' brand and not that the recoverable amount was significantly greater than the carrying amount, a new detailed calculation of the recoverable amount of the 'pie' brand will have to be performed.

Solution 11.8

Initial measurement:

Gobblers is currently shown in the balance sheet at C500 000 – which is the original cost of acquisition. It is correct to measure the initial acquisition of an intangible asset at its cost, but the information provided seems to indicate that neither amortisation has been provided nor impairment testing has been done.

Amortisation:

- It is correct that an intangible asset with an indefinite useful life should not be amortised. This brand, however, has a legal life of only 25 years and therefore should not have been classified as having an indefinite useful life.
- Amortisation of this brand should be provided over the shorter of`
  - its expected useful life – originally considered to be 'almost indefinite'
  - limited to its legal life: 25 years unless
    - the legal rights are renewable and
    - there is evidence to support renewal without significant cost.
- Since the legal life may be extended for a sum of C1 000 000, it is submitted that the legal life is not renewable 'without significant cost'. The legal life of 25 years should therefore have been a limiting factor when considering the useful life of the asset and although, the useful life of the brand is otherwise considered to be indefinite, amortisation should have been provided over 25 years.
- The residual value of this brand should be assumed to be zero on the grounds that:
  - there was no third party who had committed to purchasing the brand at the end of the useful life; and
  - there is no active market for brands making it impossible to estimate the fair value at the end of the useful life.
- The amortisation would normally be provided on the straight-line method (unless another method is considered more appropriate).
- The amortisation would therefore have been C20 000 pa (C500 000 – C0) / 25 years
- This adjustment should be treated as a correction of an error.

Impairment:

- Since unexpected diminishing profits are being earned from the gobbler products, it would appear that the future benefits from this asset are impaired.
- This should have been discovered during the required annual indicator review.
- After assessing whether the apparent drop in value is material or not, extra amortisation should first be considered.
- Assuming this was not the cause for the apparent drop in value, the recoverable amount of the brand should then have been estimated and compared with the carrying amount calculated above.

Solution 11.8 continued …

- The recoverable amount is the higher of the:
  - fair value less costs to sell; or
  - value in use.
- Since an offer has been received, the estimated fair value less costs to sell may be calculated as:

	C
Expected selling price	220 000
Less expected selling costs	2 000
	218 000

- The value in use is the C70 000 expected net cash inflows, which must first be present valued (discounted).
- The Gobblers brand should therefore be impaired to its fair value less costs to sell of C218 000 (higher than the value in use of C70 000, even before calculating the present value thereof).
- The carrying amount at 31 December 20X3 (before impairment) should be C440 000 (C500 000 – C20 000 x 3 years). The impairment loss will then be C222 000 (C440 000 – C218 000). The final carrying amount of intangible assets in the balance sheet must be C218 000.

Solution 11.9

General journal		Debit	Credit
20X1			
Research expense	*40% x 200 000*	80 000	
Development expense	*60% x 200 000*	120 000	
Bank			200 000
100% research costs and development costs expensed (recognition criteria not met: not technically feasible)			
20X2			
Development asset: cost		900 000	
Bank			900 000
100% development costs capitalised (relevant definitions and recognition criteria met)			
Impairment loss expense - development	*Cost 900 000 - RA 800 000*	100 000	
Development asset: accumulated impairment losses			100 000
Impairment of development asset: competition from Blue Sky Limited would have affected profitability projections			
20X3			
Research expense		40 000	
Administration expense		60 000	
Development asset: cost		300 000	
Bank			400 000
Research and admin costs expensed and development costs capitalised (relevant definitions and recognition criteria met)			
Development asset: accumulated impairment losses		100 000	
Impairment loss reversed - development			100 000
CA: (900 000 + 300 000 – 100 000): 1 100 000 - RA: 1 300 000 limited to original cost: 900 000 + 300 000: 1 200 000			
Development impairment in 20X2 reversed in 20X3 due to reasons for previous impairment having disappeared			
20X4			
Amortisation - development		240 000	
Development asset: accumulated amortisation			240 000
Amortisation on development asset: amortisation starts from date asset was available for use:			
CA: (900 000 + 300 000 – 100 000 + 100 000) / 5 years x 1 full year			

Solution 11.10

a) Recognition and measurement: brands

i) Recognition: Orange blossom Brand versus Infused ginger Brand

- The Orange blossom brand is a brand that was purchased.
- There is therefore a reliable measure of its value (being the purchase price of C2 000 000) with the result that it may be capitalised (assuming the rest of the definition and recognition criteria are met).
- The Infused ginger brand, on the other hand, is internally generated.
- Internally generated brands may not be capitalised on the basis that it is not possible to reliably estimate their cost.

ii) Measurement: residual value for purposes of amortization: Orange blossom versus Infused ginger

- The Infused ginger brand is expensed, thus there will be no amortization thereof – the discussion of residual value is therefore not applicable to the Infused ginger Brand.
- The Orange blossom brand is capitalised and has a finite life, and thus it must be amortised.
- The discussion of the residual value is therefore relevant:
  - There is no evidence of a third party offering to purchase the brand at the end of its useful life; and
  - There is no active market by way in which a residual value could be determined,
  - The residual value should be taken to be zero.

iii) Measurement models: Orange blossom versus Infused ginger

- The Infused ginger brand is expensed, the application of a measurement model is not applicable.
- The Orange blossom brand has been acquired and thus capitalised. Therefore Beehive Limited is able to choose between two models.
- Either the cost model or the revaluation model may be used.
- The IFRS on intangible assets requires, however, that the fair value used in the revaluation model be determined in accordance with an active market.
- Therefore, there is no active market for the Orange blossom brand, the revaluation model may not be used and therefore the cost model is the appropriate model to use for the Orange blossom brand.

Solution 11.10 continued …

iv) Journal entries required:

	Debit	Credit
1 April 20X6		
Orange blossom Brand asset	2 000 000	
Bank/ accounts payable		2 000 000
Purchase of Orange blossom Brand		
May 20X6		
Infused ginger Brand expenses	300 000	
Bank/ accounts payable		300 000
Development of internal brand: Infused ginger		
31 December 20X6		
Amortisation	150 000	
Orange blossom Brand: accumulated amortisation		150 000
Amortisation of Orange blossom Brand:		
(2 000 000 – 0) / 10 x 9 /12		

b) Recognition and measurement: research versus development of lollipop flashlight

i) Recognition: research versus development

- Since research is conducted in the very early stages of the research and development process, and is the search for new information and knowledge rather than the practical application thereof,
- there can be no future economic benefits expected (or the expected future economic benefits cannot be said to be probable).
- This therefore means that the cost of research cannot be capitalised and must always be expensed.
- Development is the application of the research findings and
- Therefore there is a chance that there are expected future economic benefits that are probable.
- There are six recognition criteria that must all be met in which case the development costs must be capitalised.
- If one of these six recognition criteria are not met, the development costs must be expensed.
- Since all criteria were met in 20X4, the development costs incurred in 20X4 must be capitalised.
- Since cash flow problems were being experienced in 20X5, one of the criteria for recognition, being 'are there sufficient resources to complete the development and use/ sell the item', was not met,
- with the result that the development costs incurred in 20X5 must be expensed.
- Once the cash flow problems were removed:
  - development costs incurred in 20X6 must be capitalised, but
  - the development costs incurred and expensed in 20X5 may not be subsequently capitalised.

Solution 11.10 continued …

ii) Measurement: amortization and impairment testing of development costs
- Since research costs are expensed, neither amortization nor impairments are relevant.
- Where development costs are capitalised, they will, until completion (and therefore available for use), be considered to be an 'intangible asset not yet available for use'
- and as a result, these costs will:
  - not be amortised, but
  - will be tested for impairment annually:
    - since there were cash flow problems during 20X5, (which resulted in the expensing of the development costs), the development asset at 31 December 20X4 may need to be impaired at the end of 20X5;
    - this impairment (that may need to be processed in 20X5) may then be reversed in 20X6 when the cash flow problems are resolved;
    - the development costs expensed during 20X5 may not be subsequently capitalised in 20X6 (recognition issue discussed in part (a) above);
  - the impairment test requires the calculation of the recoverable amount.
- Only once the development is complete, will amortization of the development asset begin.
- The amortization will be:
  - capitalised to the product/ asset being developed or
  - expensed if no inventory or other property, plant and equipment is created through the use of the development asset.

c) Measurement: useful life of the patent

- Since the patent is purchased and was capitalised, one must determine whether it has a finite or indefinite useful life.
- Since there is a finite life (both actual and legal), the patent must be amortised.
- Since the patent is to be amortised, the useful life for purposes of amortization must be estimated.
- The useful life will be:
  - the shorter of its actual life (20 years) and its legal life (5 years).
  - however, the legal life of 5 years is renewable and is renewable at an insignificant cost (C30 000 for a period of 3 years relative to the cost of C5 000 000 for a period of 5 years), this legal life may be taken to be 8 years instead (5 years + 3 years).

Solution 11.11

Part A

An expense for advertising and promotional activities is recognised when the entity has a right to access those goods (IAS 38, p69).

The company had access to the catalogues when they were received from the printers on 15 September. Therefore, an amount of C24 000 is recognised as an expense on the statement of comprehensive income for the year ended 30 September 20X8.

Even though the catalogues are distributed evenly from 15 September to 15 December, the expense is not apportioned between the 20X8 and 20X9 financial years and no asset is recognised at 30 September 20X8.

Part B

An entity is not precluded from recognising a prepayment as an asset when payment for the goods has been made in advance of the entity obtaining a right to access those goods (IAS 38, p70).

The company had paid for the catalogues on 15 August 20X8 but will only have access to them on 15 September, which is after the year end of 31 August. Therefore, an amount of C24 000 is recognised as an asset in the statement of financial position at 31 August 20X8.